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TAGS: [ECON](#) [EFIN](#) [ETRD](#) [PGOV](#) [PREL](#) [BB](#) [XL](#)
SUBJECT: BARBADOS' ECONOMY: A PERSPECTIVE FROM THE CENTRAL
BANK

REF: A. BRIDGETOWN 2176
[1](#)B. BRIDGETOWN 2228

Classified By: DCM Mary Ellen T. Gilroy for reasons 1.4 (b) and (d).

[1](#)1. (C) Summary: Barbados' economy continues to grow at a steady pace and is projected to expand by 3.4 percent in [1](#)2006. However, a recent meeting with Central Bank of Barbados (CBB) Senior Director for Research revealed the CBB's concerns over the economy's medium to long-term health. Barbados' economy has been hemorrhaging foreign exchange at a rate of about BDS200 million per year as a result of booming consumer and government spending and weak growth in those sectors of the economy that generate foreign exchange. On December 15, the CBB raised interest rates for the fifth time in two years, hoping to contain consumer credit demand and spending. In the long term, the CBB is calling for a reorienting of Barbados' economy toward services and industries that can generate the needed foreign exchange. PM/Finance Minister Arthur's government, however, is focused on the shorter-term goal of cultivating electoral support for probable parliamentary elections after the March-April 2007 Cricket World Cup events. End Summary.

AN ECONOMY STARVED FOR FOREIGN EXCHANGE

[1](#)2. (SBU) On December 20, PolOff met with Dr. Daniel Boamah, Senior Director for Research at the Central Bank of Barbados. Predictably, Boamah proved to be far less sanguine about the health of Barbados' economy than Minister of State at the Finance Ministry, Clyde Mascoll, with whom PolOff spoke earlier (ref A). The meeting with Boamah came only a few days after the December 15 interest rate hike, the fifth in two years, as the CBB continues its efforts to contain domestic demand. Boamah expressed strong concerns about continued pressure on the country's foreign exchange reserves. The economy has been losing about BDS200 million in foreign exchange a year, and the government has had to resort to loans in both 2005 and 2006 to shore up its foreign exchange reserves. Over the past three years, imports have surged to meet rising consumer spending, driven by an explosion in the use of credit cards and other consumer credit loans. The government's extensive capital works spending, much of it in preparation for hosting the 2007 Cricket World Cup (CWC), has also contributed to the problem. Boamah noted that the CBB's "preemptive action" on interest rates may be having some effect, in that recent data indicate a decrease in credit growth, imports, and current account deficit.

¶3. (SBU) Even if the interest rate hikes have the desired effect, Boamah argued that the country cannot sustain the continued drain of foreign exchange over the medium to long term. According to CBB forecasts, the Barbadian economy will register a 3.4 percent GDP growth in 2006. According to Boamah, under normal circumstances, a 3.4 percent growth would be respectable, but in Barbados' case, the economy is not growing "fast enough," especially in sectors that earn foreign exchange. Boamah estimated that only one-third of Barbados' economy is generating foreign exchange at present, while the other two-thirds are consuming it.

¶4. (C) Both Boamah and the CBB Governor, Dr. Marion Williams, have publicly called for structural changes in the economy to reverse the drain of foreign exchange. While the government has focused on expanding the country's tourism sector, Boamah said that relying on this vulnerable sector's growth alone was insufficient. Boamah also dismissed the recent surge in land and real estate sales to foreign buyers as a "shortsighted strategy." While selling land has been generating foreign exchange and paying the bills for now, Boamah wondered what would happen when all the land is gone or, as is more likely, Barbados' real estate bubble bursts. The government would also like to expand Barbados' off-shore financial services sector, according to Boamah, but has been cautious because "the OECD is on our back." In the long term, the CBB Governor pointed to increased investment and expansion in export-oriented manufacturing and services as the only path toward securing Barbados' economic future.

INFLATION SHOULD EASE IN 2007

¶5. (C) Although concerns over the rising cost of living have generated innumerable front-page stories in the local press and much political infighting, Boamah thought that inflation would level off in 2007. According to the CBB's latest statistics, the rate of inflation stood at 7.5 percent at the end of August 2006, and Boamah expected that rate to drop slightly for the year thanks to the recent reduction in energy prices. The CBB's projections for 2007 show inflation dropping to about 5.5 percent. While he agreed with Finance Minister of State Mascoll's view that Barbadian consumer patterns have changed and may be contributing to the rising cost of living (ref A), Boamah believes that the country's inflation will continue to be driven mainly by higher energy costs. Nevertheless, he noted that the recent 10 percent wage hike approved by the government for Barbados' public servants will do nothing to help keep prices down (ref B).

BUT GDP GROWTH ALSO LOWER

¶6. (C) The CBB's projection of 3.4 percent GDP growth in 2006 is about 0.5 percent lower than earlier forecasts. Boamah said that the CBB also revised downward its projections for 2007 and 2008. Even accounting for the expected economic impact of the CWC, Boamah anticipates growth of only 3.5 percent in 2007, and 2 percent in 2008 and thereafter. Boamah clearly did not share the government's optimism about a significant economic impact of the CWC in 2007 and beyond. To give the country's economy a real boost, Boamah said, the government should "scale back its fiscal activities to make room for the private sector."

COMMENT

¶7. (C) That piece of good advice, however, will likely go unheeded by Prime Minister Arthur's government which is trying to set the stage for the next parliamentary elections, expected in 2007. The government's generous wage package for public servants, a recent cut in the price of gasoline, and construction projects all over the island are being interpreted--and parodied in the press--as signs that the elections are near. Even Boamah at one point indicated that

PM Arthur, who also holds the Finance Ministry portfolio, initially opposed the CBB's most recent interest rate hike. While his political instincts were probably telling the Prime Minister that higher interest rates would not play well with the electorate, the economist in him eventually must have recognized the necessity of some belt-tightening. That PM Arthur will increasingly view key policy decision through the prism of approaching elections is not surprising. In practice this will likely mean that needed economic reforms and policies that may involve some pain will be put on the back burner until after the elections. Despite the cautious note sounded by Boamah, PM Arthur may have the luxury of delaying action because the Barbadian economy remains in relatively good shape and only a significant external shock--a spike in energy prices or a sharp drop in tourism--would necessitate more immediate adjustments.

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